



DEPARTMENT OF  
**FINANCE**

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May 2, 2006

Mr. William L. Gausewitz, Director  
Office of Administrative Law  
300 Capitol Mall, Suite 1250  
Sacramento, CA 95814

Dear Mr. Gausewitz:

**Final Report: Office of Administrative Law—Internal Control Review**

Enclosed is our final report on the Office of Administrative Law's (Office) internal control as of December 21, 2005. The Department of Finance, Office of State Audits and Evaluations (Finance), performed this review in accordance with the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400 et seq.

The Office's response is included herein. The implementation of the corrective actions strengthens the Office's internal control and reduces the risk of errors or irregularities.

The final report will be placed on the Finance website in accordance with Finance's policy of increased transparency. We appreciate the assistance and cooperation of staff and management during our review. If you have any questions, please contact Susan M. Botkin, Manager, or Dennis Mehl, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by Diana L. Ducay

Diana L. Ducay, Chief  
Office of State Audits and Evaluations

Enclosure

cc: Ms. Belinda Aldrete, Office of Administrative Law

# AN INTERNAL CONTROL REVIEW

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## OFFICE OF ADMINISTRATIVE LAW

Prepared By:  
Office of State Audits and Evaluations  
Department of Finance

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The Office of Administrative Law (Office) is responsible for reviewing administrative regulations proposed by over 200 state agencies for compliance with standards set forth in California's Administrative Procedure Act, for transmitting these regulations to the Secretary of State, and for publishing regulations in the California Code of Regulations. The Office assists state regulatory agencies, through a formal training program, to understand and comply with the Administrative Procedure Act.

State managers are required to maintain internal control in the programs they administer. Internal control is defined as a process designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations. This definition of internal control includes five interrelated components:

- *Control environment* sets the tone of an organization, influencing the control consciousness of its staff. It is the foundation for all other components of internal control, providing discipline and structure.
- *Risk Assessment* is the entity's identification and analysis of relevant risks to the achievement of its objectives, forming a basis for determining how the risks should be managed.
- *Control Activities* are the policies and procedures that help ensure management directives are carried out.
- *Information and communication* are the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
- *Monitoring* is the process that assesses the quality of internal control performance over time.

The objective of our internal control review was to assist the Office in complying with the Financial Integrity and State Manager's Accountability Act of 1983. Specifically, we assisted the Office in determining whether: (1) assets are safeguarded from unauthorized use or disposition, (2) financial transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of reliable financial statements, and (3) financial operations are conducted in accordance with State Administrative Manual guidelines, and certain other state laws and regulations, as well as the Office's policies and procedures.

This report is intended for the information and use of the Office and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

**STAFF:**

Susan M. Botkin, CGFM  
Manager

Dennis Mehl  
Supervisor

Michael Bratman  
Auditor

## EXECUTIVE SUMMARY

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During our review of the Office of Administrative Law's (Office) internal control, we identified several areas where controls were in place and working as intended. We also identified areas where controls could be improved to reduce the risk of errors, irregularities, and material misstatements. We met with management and staff to discuss the following weaknesses, as well as other non-reportable findings and observations.

The Department of General Services' (DGS), Contracted Fiscal Services (CFS) and Office of Human Resources provide accounting and personnel services to the Office. Therefore, the following comments are limited to functions or activities performed by the Office.

*Administrative Controls:* The Office does not have adequate written procedures for a number of business functions and there is key person dependency.

*Cash Receipts:* Controls over cash receipts are inadequate to ensure the proper safeguarding of state assets.

*Receivables:* Controls over account receivables are inadequate to insure that amounts due the Office are collected.

*Purchasing:* Controls over purchasing are insufficient to ensure that purchases of goods and services are recorded and received.

*Fixed Assets:* Internal controls over property are inadequate to insure that all equipment is tagged.

There were no significant findings for the Office's budget and contract functions.

For further analysis of the weaknesses summarized above, see the Findings and Recommendations section of this report.

This report is intended to assist the Office's management in focusing attention on areas of risk and in strengthening internal control and improving operations.



## AUDITOR'S REPORT

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Mr. William L. Gausewitz, Director  
Office of Administrative Law  
300 Capitol Mall, Suite 1250  
Sacramento, CA 95814

We have reviewed the Office of Administrative Law's (Office) internal control as of December 21, 2005 for conformity with Government Code Section 13400 et seq. Our review included obtaining an understanding of internal control through observations and interviews, identifying risks, testing and evaluating the design and operating effectiveness of the internal control, and performing other procedures we deemed necessary under the circumstances.

The Office's management is responsible for establishing and maintaining adequate internal control. This responsibility, in accordance with Government Code Section 13400 et seq., includes documenting internal control, communicating control requirements to employees, and assuring that the internal control is functioning as prescribed. In fulfilling its responsibility, management is required to assess the expected benefits and costs of its control procedures.

The objectives of internal control are to provide reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition.
- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements.
- Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual, and certain other state laws and regulations, as well as the Office's policies and procedures.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any review of internal control to future periods are subject to the risk that the internal control may become inadequate because of changing conditions, or that compliance with control policies or procedures may decline.

In reviewing the Office's internal control as of December 21, 2005, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the

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Office's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a condition that precludes the Office's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented, or detected on a timely basis. We believe the reportable conditions concerning Administrative Controls and Cash Receipts are material weaknesses. These weaknesses and other reportable conditions are described in the *Findings and Recommendations* section of this report.

This report is intended for the information and use of the Office's management, and is not intended to be used by anyone other than the designated parties. However, this report is a matter of public record and its distribution is not limited.

Original signed by Diana L. Ducay

Diana L. Ducay, Chief  
Office of State Audits and Evaluations  
(916) 322-2985

December 21, 2005



## FINDINGS AND RECOMMENDATIONS

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We reviewed the accounting and administrative controls within the Office of Administrative Law (Office). During our review, we noted that a number of controls were functioning as intended. However, we also identified areas where controls are not in place and where corrective action is necessary, as described below.

### **Administrative Controls**

Administrative or managerial controls relate to operational efficiency, adherence to managerial policies, and management's authorization of transactions. Department management is responsible for overseeing activities conducted within their agencies. This responsibility includes the establishment and maintenance of internal accounting and administrative controls over operations.

#### **FINDING 1                      Key Person Dependency**

Condition:                      There is a key person dependency at the Office. The Administrative Assistant II is solely responsible for most administrative and business functions. There are no trained backup staff and there is an absence of written desk procedures.

Criteria:                      Government Code (GC) Section 13403 states that the elements of a satisfactory system of internal accounting and administrative controls shall include an established system of practices to be followed in performance of duties and functions in each state agency.

Recommendation:                      Develop written desk procedures and cross-train staff.

#### **FINDING 2                      Lack of Written Procedures**

Condition:                      There is a lack of written procedures for the following functions:

- Budgets
- Cash Receipts
- Account Receivables
- Cash Disbursements
- Revolving Fund
- Contracts
- Fixed Assets

Criteria: State Administrative Manual (SAM) Section 20050 states that the elements of a satisfactory system of internal accounting and administrative controls shall include a system of authorization and record keeping procedures adequate to provide effective accounting controls.

Recommendation: Develop written procedures for the various accounting and business functions.

### **Cash Receipts**

Effective controls over cash receipts are necessary to ensure all amounts are properly safeguarded, collected, and deposited in a timely manner. We observed the following weaknesses relative to Cash Receipts.

#### **FINDING 3 Inadequate Separation of Duties Over Cash Receipts**

Condition: There is inadequate separation of duties over cash receipts. One person records the checks in the report of collections form, endorses the checks, and sends the information and vendor invoices to Contracted Fiscal Services (CFS).

Criteria: GC Section 13403 states that a satisfactory system of internal accounting and administrative controls shall include a plan of organization that provides segregation of duties appropriate for proper safeguarding of state assets.

Recommendation: Ensure that there is adequate separation of duties.

#### **FINDING 4 Checks are Not Endorsed Promptly Nor Securely Stored**

Condition: Checks are not endorsed on a timely basis. Checks may accumulate for several weeks before they are endorsed and a report of collections prepared. Also, the checks are not centrally received or securely stored in the safe.

Criteria: SAM Section 8023 states that checks will be restrictively endorsed for deposit as soon as possible, but no later than the end of the working day. GC Section 13403 requires adequate measures to safeguard assets.

Recommendation: Establish procedures to centrally receive checks, endorse them on the day of receipt, and store the undeposited checks in the safe.

### **Account Receivables**

Effective internal control over receivables is necessary to ensure all amounts due are promptly collected and properly recorded. The following weaknesses were identified.

**FINDING 5                      Invoices Are Not Being Prepared and Submitted to CFS**

Condition:                      Invoices for training classes are not being prepared or submitted to clients and CFS. Additionally, there are no subsidiary records.

Criteria:                        SAM Section 8776.3 requires than an invoice or other type of claim document be prepared and sent to the recipient of services as soon as possible. SAM Section 7800 states that subsidiary records should be established and reconciled to the general ledger monthly.

Recommendation:            Prepare invoices for submittal to clients and CFS. Ensure the general ledger reflects the accounts receivable balance and is properly reconciled.

**FINDING 6                      Inadequate Separation of Duties**

Condition:                      Both positions involved in receivables originate billing information, prepare invoices, review invoices for accuracy, maintain their own receivables ledgers, and perform other receivables functions.

Criteria:                        GC Section 13403 states that a satisfactory system of internal accounting and administrative controls shall include a plan of organization that provides segregation of duties appropriate for proper safeguarding of state assets.

Recommendation:            Ensure there is adequate separation of duties.

**FINDING 7                      Inadequate Collection Efforts**

Condition:                      There are inadequate efforts to collect amounts due for training courses and publications. There is no, or minimal, follow-up to collect amounts owed the Office for services and goods provided.

Criteria:                        SAM Section 8776.6 states that each department will develop collection procedures that will assure prompt follow-up on receivables.

Recommendation:            Develop procedures to collect outstanding receivables.

**Purchasing**

Effective internal controls over purchasing are necessary to ensure that only proper payments are made and goods received match purchase orders. The following weakness was identified.

**FINDING 8                      Stock Received Reports Are Not Being Processed and Compared to Invoices**

Condition:                      Stock received reports are not being prepared, and there are no markings on the purchase orders to indicate that goods have been received. Also, items received are not matched to the purchase order and related invoice.

Criteria: SAM Section 8422.20 states that agencies will prepare stock received reports or use an approved purchase order document to record receipt of the goods. SAM Section 8422.1 states that the itemized receiving reports should equal the invoice.

Recommendation: Develop procedures to record receipt of purchases, and compare the items received to the purchase orders and related invoices.

### **Fixed Assets**

The combination of accurate accounting records and strong internal controls must be in place to protect against and detect the unauthorized use of state property. The following weakness was identified.

#### **FINDING 9                      Equipment is Not Properly Tagged**

Condition: Several items of sensitive equipment were not tagged. Additionally, a laptop computer was not tagged for six months after the computer was purchased. This also results in CFS not receiving information to update the inventory.

Criteria: SAM Section 8651 requires that all state property to be tagged after acquisition.

Recommendation: Tag equipment when it is received or acquired, and submit inventory information to CFS.

## CONCLUSION

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Our review of the Office of Administrative Law's (Office) internal control presents opportunities for the management to correct identified weaknesses and improve its operations. We believe internal control would be strengthened and the Office would operate more effectively if the Office implements our recommendations. The reportable conditions, if left uncorrected, increase the risk that material errors or irregularities could occur and remain undetected, and the material weaknesses, if left uncorrected, could adversely affect the Office's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

The findings in this report are based on fieldwork performed between November 9, 2005 and December 21, 2005. We presented these findings to the Office at the completion of each cycle and at the exit conference held on December 21, 2005.



**OFFICE OF ADMINISTRATIVE LAW**

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**WILLIAM L. GAUSEWITZ**  
Director

April 24, 2006

Diana L. Ducay, Chief  
Office of State Audits and Evaluations  
Department of Finance  
300 Capitol Mall, Suite 801  
Sacramento, CA 95814

Dear Ms. Ducay:

The Office of Administrative Law (OAL) would like to thank the Department of Finance (DOF), Office of Audits and Evaluations for the review of its Internal Control functions.

OAL has reviewed the Report and concurs with its findings. Following our audit in December 2005, OAL addressed and has corrected these findings. OAL developed an administrative desk manual on all its accounting and business procedures, and has crossed trained the support staff. Additionally, OAL is in the process of hiring two support staff to alleviate the workload.

Further, OAL found this audit to be very valuable, and appreciates DOF for its great information and assistance.

Sincerely,

Original signed by William L. Gausewitz

William L Gausewitz  
Director

Cc: Dennis Mehl, Audit Supervisor